



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 16.07.2001
COM(2001) 399 final

**REPORT FROM THE COMMISSION
TO THE EUROPEAN PARLIAMENT AND THE COUNCIL**

**Growth and Employment Initiative
Measures on financial assistance for innovative and job creating
Small- and Medium Sized Enterprises (SMEs)**

(SEC(2001)1139)

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As at 31 December 2000

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Growth and Employment Initiative

1. GENERAL INTRODUCTION

The 2000 annual report on the Growth and Employment Initiative is drawn up in accordance with Article 7(1) of the Council Decision (Decision 98/347/CE) adopted on 19 May 1998. This Decision requires the Commission to submit an annual report to the European Parliament and Council on the progress achieved on the implementation of three financial instruments, ETF Start-up Facility, JEV and SME Guarantee Facility. This is the second report of this type, which reviews the developments that have occurred since 1999 and outlines future prospects of the Initiative.

The report is broken down into three sections, one for each of the financial instruments. It is complemented by annexes, referring particularly to statistics on SMEs that are beneficiaries of either the ETF Start-up Facility or the SME Guarantee Facility. These statistics are based on questionnaires and data, concerning the year 1999, that were submitted to the Commission at the end of 2000. These data available now for the first time, were not annexed to the first report. Finally, the conclusion describes further developments of the Initiative within the context of the multiannual programme for enterprise and entrepreneurship (2001-2005).

The European Parliament's "Committee on Employment and Social Affairs" has submitted a report (A5-0335/00) responding to the Commission's first annual report on the Growth and Employment Initiative in November 2000.

The Presidency conclusions of the Lisbon European Council of 23-24 March 2000 call for new strategic goals for the Union: to become the most dynamic and competitive knowledge-based economy in the world, to be capable of sustainable economic growth with more and better jobs and to have greater social cohesion. The Lisbon conclusions consider SMEs to be strategic tools for the development of a dynamic and competitive knowledge-based economy. Measures to foster their development focus on improving Community financial instruments for SMEs and on creating a friendlier environment for starting up and developing businesses.

In response to a request by the Lisbon European Council, the Commission prepared a review paper in October 2000 on specific Community financial instruments for SMEs, setting up a framework for future Community action which should continue to be offered through four windows (loans, equity, guarantees and grants). The Ecofin Council welcomed the review paper on 7 November 2000. It also agreed to the Commission's proposal to regroup similar Commission financial instruments under one budget line and one legal basis. As a consequence, several Community SME programmes have been included under the framework of the multiannual programme for enterprises and entrepreneurship 2001-2005 (MAP), which was approved by the Council on 20 December 2000 (2000/819/EC). The new MAP proposes modifications and extensions of the ETF Start-up Facility and the SME Guarantee Facility, and it foresees a simplification of the JEV programme and an adaptation of its eligibility criteria in order to respond more effectively to the needs of SMEs. Furthermore, the Seed Capital action (formerly CREA), constitutes an integral part of the financial instruments of the MAP.

Two of the instruments of the Growth and Employment Initiative are managed on a trust basis by the European Investment Fund (EIF). In this context it is worth mentioning that the June 2000 reform of the EIF has turned it into the EIB Group's specialist risk capital arm and strengthened its role as a guarantor to ensure continued efficient support for SMEs. The aim is to achieve the Community objectives in these key areas for growth and employment in the Member States of the Union and, for the first time, also in the Accession countries.

2. ETF START-UP FACILITY

2.1. Introduction

Technology-based and innovative SMEs, as well as start-ups, often experience difficulty in accessing traditional finance due to problems such as the relatively high proportion of intangible assets and the lack of stable cash flows. They are often regarded to be higher risk than SMEs in the traditional sectors. Hence the need for venture capital, which becomes a crucial source of financing for these SMEs. Increasing the need for venture capital is the fact that many innovative SMEs are growing or are expected to grow at a high rate, making equity-based finance the most appropriate for their needs.

There has been a significant increase in the availability of European venture capital over the past few years. The European Venture Capital Association (EVCA) 2000 Yearbook indicates that venture capital investment in 1999 has increased by 70% from the previous year, to about EUR 12 billion (0.14% of the gross domestic product - GDP).

Despite the rapid growth of the EU venture capital market over the past 5 years, it still remains significantly behind that of the US. Furthermore, the EU private equity market tends to focus on more profitable later-stage investments rather than the early-stage investments of technology-based and innovative SMEs.

However, in recent years there has been a shift towards early stage and high technology investments. EVCA figures show that early-stage investments in 1999 had doubled to EUR 3 billion relative to 1998, and were ten times higher than in 1995. An analysis of the expected allocation of funds raised in 1999 confirms this trend, with about EUR 5.5 billion (22% of total funds raised) earmarked for future early-stage investments.

According to the EVCA 2000 mid-year survey, during the first six months of 2000, 44% of European investee companies were in the seed or start-up phase, while 19% of the total investments were allocated to these companies. The average amount invested was EUR 1 million in seed companies and EUR 1.4 million in start-up companies. High technology companies make up almost 50% of the total investee companies and have received 33% of the total amount invested. However, the recent downturn in technology stocks may alter these figures substantially.

The ETF Start-up Facility is operated by the EIF that contributes to the pursuit of Community objectives; in particular it is committed to the development of a knowledge-based society, centred on innovation, growth and employment, the promotion of entrepreneurial spirit, the regional development and the cohesion of the Union.

The EIF acts independently and commercially under market conditions. According to Art. 24 of its statutes, it targets appropriate returns for its shareholders.

The following chapters on the ETF Start-up Facility have been drafted on the basis of the annual reports provided by the venture capital funds participating in the ETF Start-up Facility to the EIF. This information relates to 31 December 2000.

The report is complemented by a specific SME annex (annex 2) based on a survey carried out in mid-2000 on the beneficiary SMEs, which were invested in by venture capital funds

participating in the ETF Start-up Facility. It is important to stress that this information refers to the year 1999.

2.2. Description of the Facility

The objective of the ETF Start-up Facility is to increase the availability of risk capital to innovative SMEs during their establishment and their early stage development.

The EIF invests in specialised venture capital funds (hereunder referred to as VC funds) established specifically to provide equity or other forms of risk capital to SMEs. The funds considered under this Facility are smaller or newly established ones, in particular those operating at a regional level, those focusing on specific industries or technologies and those which finance the exploitation of R&D results.

Investments are made on equal terms with other equity investors and must represent between 10% and 25% of the total capital of the VC fund, up to a maximum of EUR 10 million.

In order to offer the EIF some flexibility in its selection of funds and not to exclude otherwise strong candidates, the Investment Policy of the Facility allows VC funds to make available a small percentage of their capital to investments outside the EU. In this case the EIF's participation in the venture capital funds is reduced by the corresponding percentage.

The EIF examines the fund proposals based on criteria such as size, level of involvement from the private sector, investment strategy, target market, deal flow, proposed terms, expected rate of return, management team working on the project and lastly on the extent to which the EIF investment in the VC fund is expected to have a catalytic effect in raising funds. Attention is also given to ensuring that the programme as a whole maintains a balanced geographical representation across the European Union.

Following eligibility approval of the VC fund proposals by the Commission, the EIF signs contractual agreements with the fund managers and the other equity investors in the fund. Thereafter the EIF progressively disburses the amounts committed to the VC funds for investment in SMEs.

2.3. Budgetary situation

2.3.1. Overview

As on 31 December 2000, the total budgetary appropriations of the ETF Start-up Facility amounted to EUR 168 million, including EUR 59 million allocated in 2000.

2.3.2. Geographic distribution

As on the end of 2000, investment proposals into 17 VC funds were in principle approved by the EIF and the Commission services, corresponding to a total amount of EUR 110 million. Ten contracts have been signed with the EIF and two are still under process. For the remaining five, negotiations were unsuccessful. These twelve VC funds account for an amount of EUR 80.7 million, which represents 48% of the total ETF Start-up budget allocation. The global maximum funding to be raised by these VC funds amounts to EUR 440 million.

The breakdown of the amounts corresponding to the twelve VC funds by country is shown below:

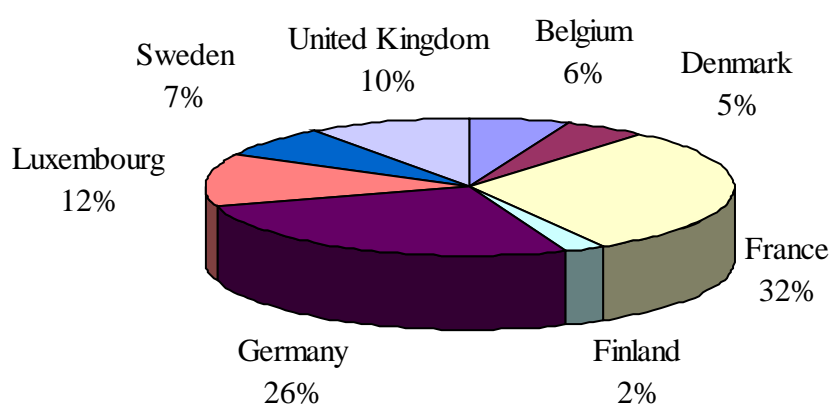


Figure 2.1. Breakdown by country of the VC funds

The ten VC funds with which the EIF has signed contracts cover six member states for a total of EUR 71.7 million. Out of this amount, EUR 12.8 million are conditional on further fund raising by the VC funds. A short description of the VC funds, which have contractual agreements with the EIF, is annexed (annex 1).

Concerning the two funds, which are still under process, the EIF expects to conclude within the coming few months.

The main reason for which negotiations were unsuccessful for the five above-mentioned VC funds is that the final investment terms, proposed by the VC fund managers, did not comply with the eligibility criteria of the ETF Start-up Facility (for example other investors received preferential terms, management fees were not calculated in accordance with market practice or over-subscription of the fund).

2.3.3. Commitments

The graph below shows the quarterly approvals of investments in VC funds. It can be noticed that the low level of activity in the year 2000 corresponds to the restructuring period of the EIF.

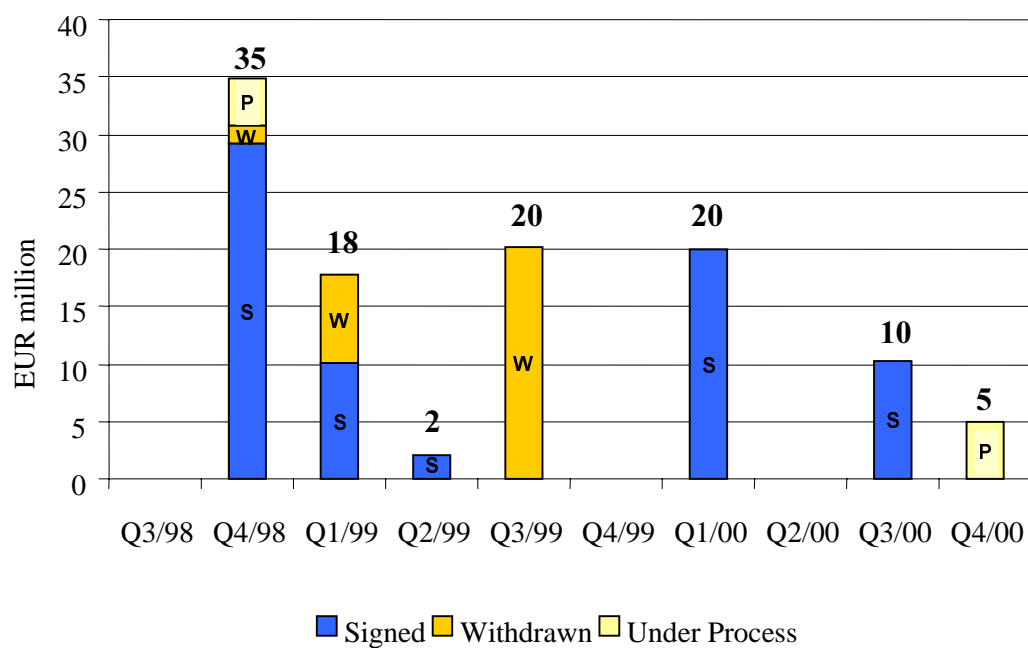


Figure 2.2. Quarterly approvals of investments in the VC funds

The graph below shows the cumulative evolution of the amounts approved in principle for 17 VC funds (EUR 110 million - end 2000) compared to the available committed budgetary resources (EUR 168 million - end 2000).

It also shows the evolution of the total amount of the on going operations (i.e. contracts signed plus those, which are still under process, corresponding to EUR 81 million - end 2000).

Finally it indicates the amounts signed by the EIF with VC funds (EUR 72 million - end 2000).

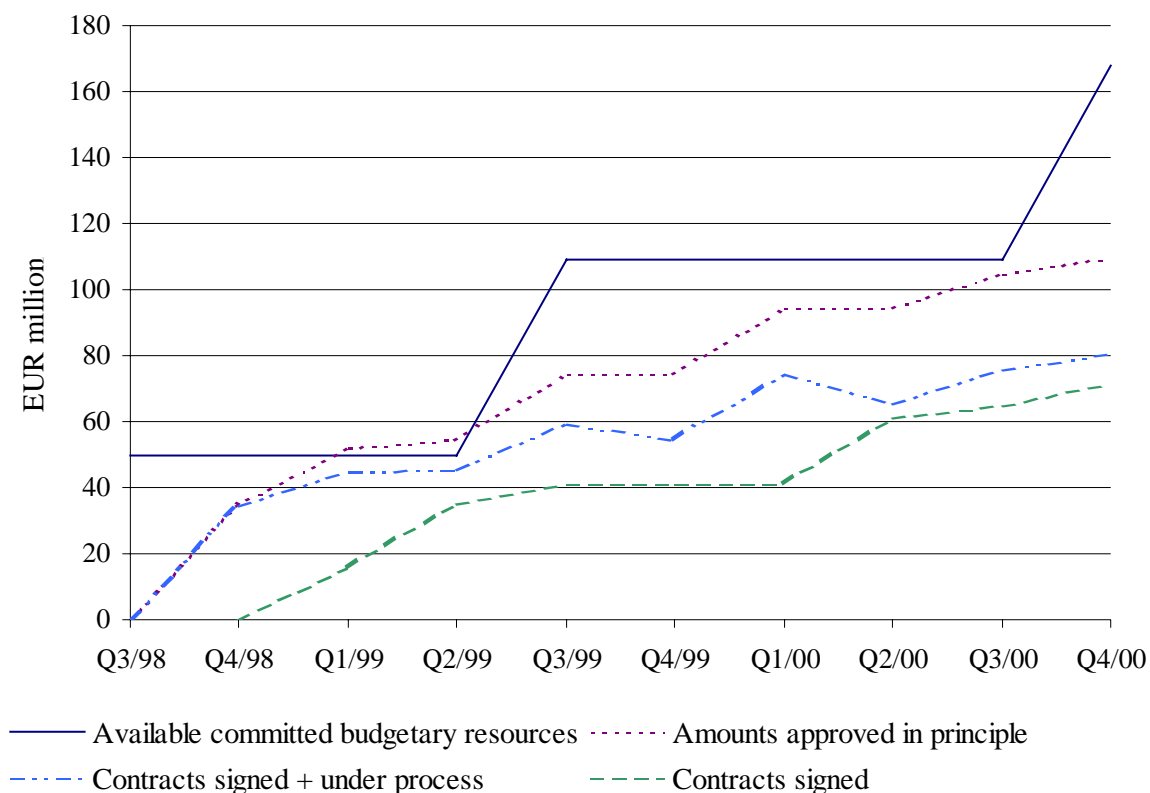


Figure 2.3. Cumulative evolution of operations

2.3.4. Disbursements

As on 31 December 2000, the total disbursements to VC funds amounted to EUR 32 million compared to EUR 12 million at year-end 1999. The overall disbursement rate is now 45% of the amounts committed.

It is worth noting that the first ETF Start-up VC funds that have signed a contract with the EIF (in the first two quarters of 1999) present an average disbursement rate of 63%. Considering that the average investment period of these VC funds is 4-5 years, the disbursement rate can be considered quite satisfactory.

The following graph shows the progress of the disbursements of budgetary commitments to the VC funds by 31 December 2000 in comparison with the amounts of the contracts signed. The disbursements of the EIF are made in parallel with all the other investors in the VC funds, pro rata of their investment commitments. The disbursements are used by the VC funds for their investment in SMEs.

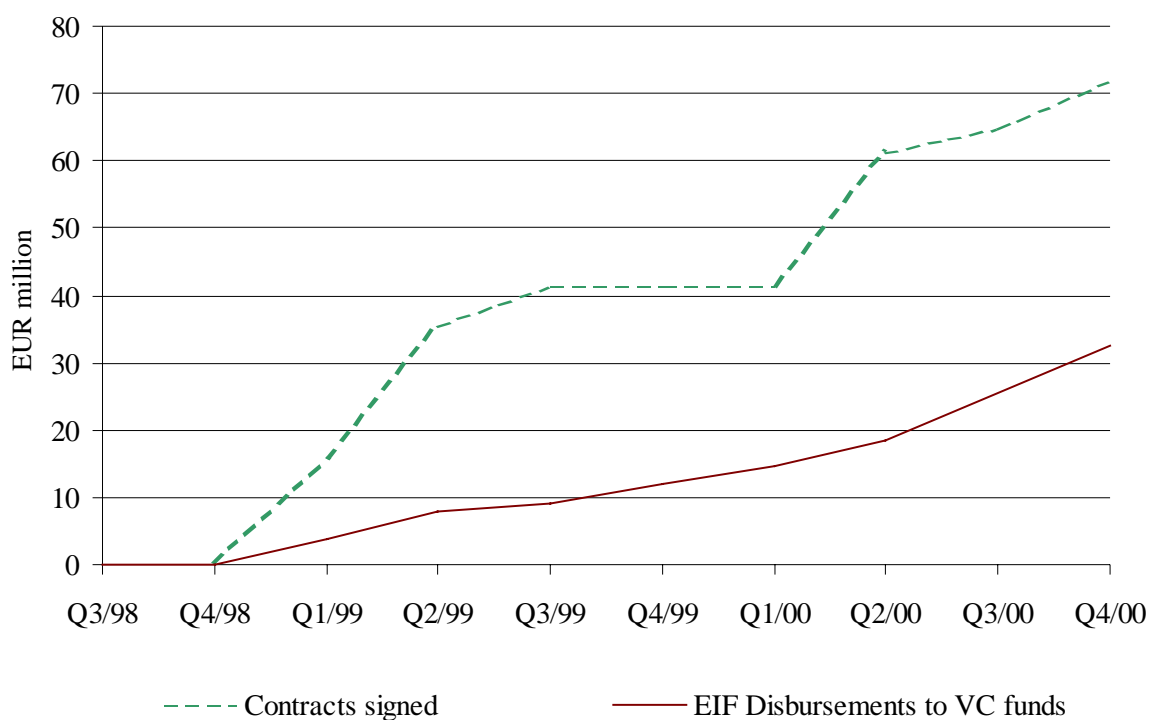


Figure 2.4. Disbursements to the VC funds

The graph hereunder shows the investments made by the VC funds in beneficiary SMEs compared to the EIF disbursements to the VC funds. End 2000 the ratio of the Facility contribution with the investment of VC funds was 1/4.

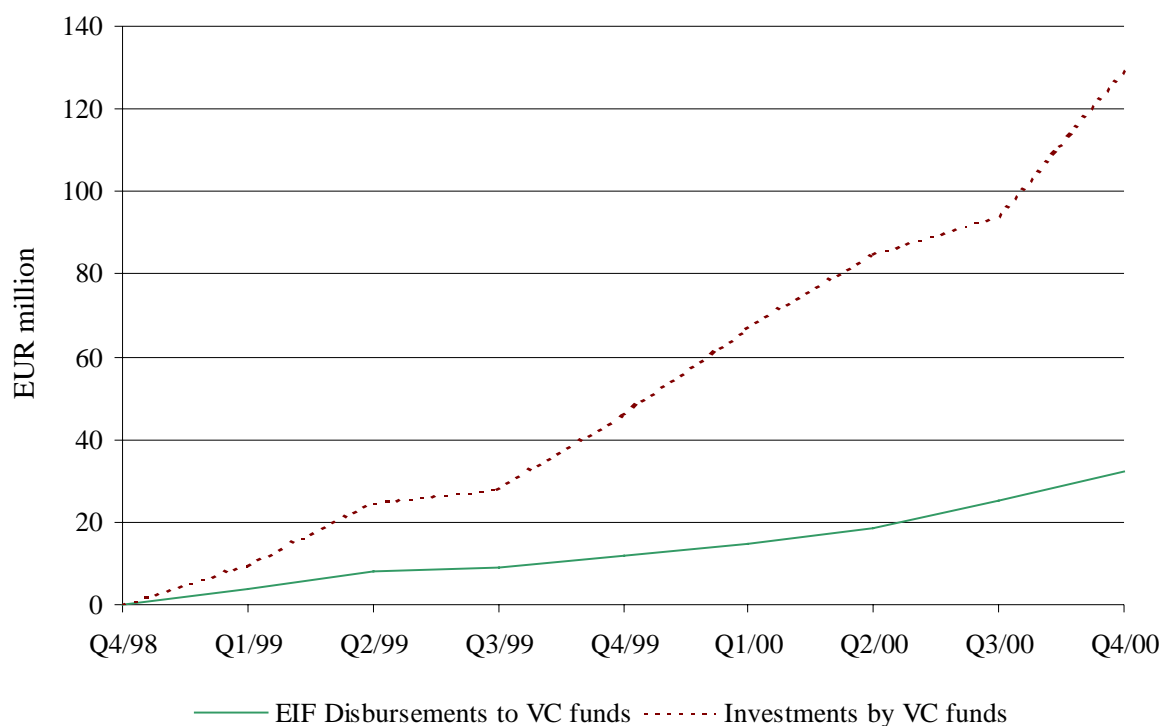


Figure 2.5. *Investments by the VC funds in beneficiary SMEs*

2.3.5. Repayments by the venture capital funds

Some ETF Start-up VC funds have started repaying the EIF, following the sale of their equity participation in some successful SMEs.

In the year 2000 a total amount of EUR 9.6 million has been repaid by the VC funds to the EIF, which compares with an amount of EUR 0.7 million in 1999.

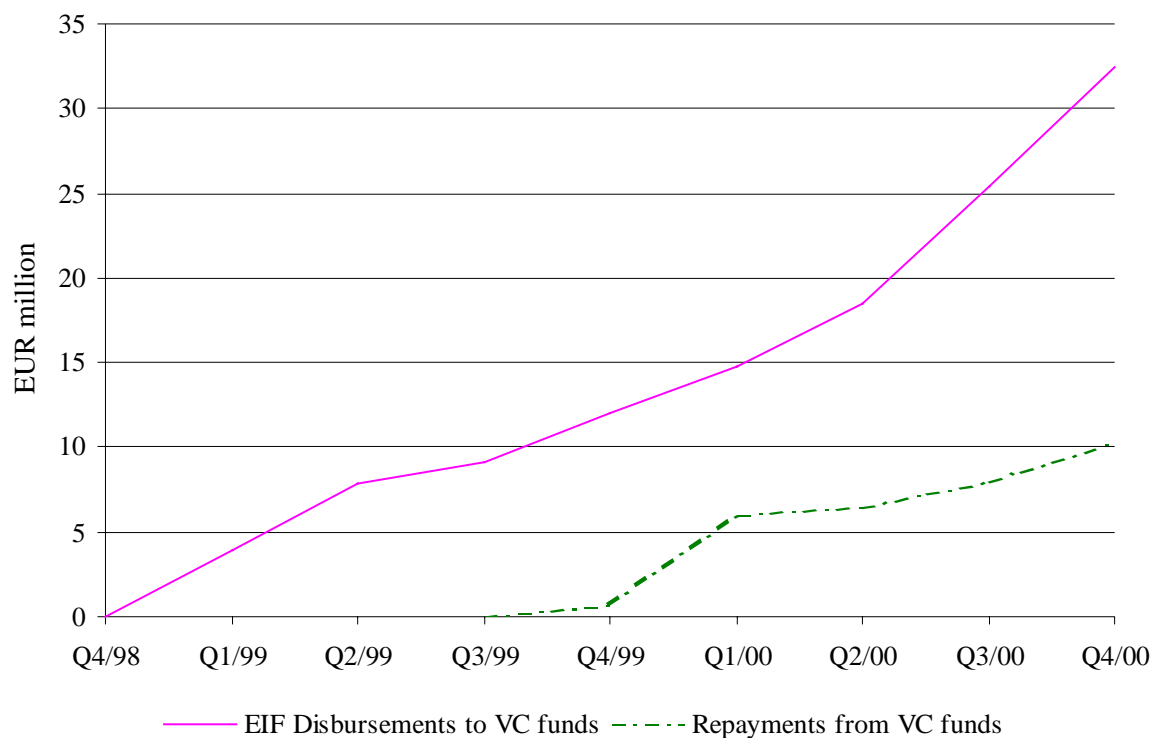


Figure 2.6. Repayments by the VC funds

According to the EIF, the performance stated above is quite encouraging considering that the first ETF Start-up contract with a VC fund was signed in January 1999. Nevertheless, the deterioration of market conditions at the end of 2000 could have an impact on the pace of profit realisation and on the further development of some firms. Indeed, the technology stock downturn has signified a decrease in the valuation of some investee companies, while others had to postpone their quotation on the stock markets.

More information on the companies concerned by these repayments is given in paragraph 2.5 hereunder.

The Council Decision foresees that proceeds from realised investments may be reinvested during the first four years of operations of the Facility. The reinvestment period can be extended by up to three years, subjects to a satisfactory evaluation of the Facility 48 months after its adoption.

2.3.6. Accounts

The financial statements of the Facility are enclosed in annex 7.

2.4. Financial Intermediaries

Most of the VC funds, which have contractual agreements with the EIF, have a national, if not regional, focus, although some of them are allowed to invest on a pan-European basis. They are mainly oriented towards early stage investments in high technology areas, such as information and communication technologies, Internet, healthcare and life sciences. This is in line with the structure and the eligibility criteria of ETF Start-up.

A short description of the VC funds, which have contractual agreements with the EIF, is annexed (annex 1).

In terms of country representation, there are still seven EU countries, which have not been covered by ETF Start-up, i.e. Austria, Greece, Ireland, Italy, Netherlands, Portugal and Spain. Apart from the Netherlands, these are the countries where the venture capital market, particularly concerning the seed and start-up phases, is the less developed. However, in the last months a growing number of proposals coming from these countries are being assessed and special operational efforts have been undertaken in respect of the development of transactions in countries where the ETF start-up Facility so far has not been used.

As far as Austria is concerned, one operation has been submitted to EIF's Board in April.

In Greece, the market conditions are such that it is difficult to identify potential investments under any of EIF's mandates.

In Ireland preliminary contacts have been established for an operation to be placed in the pipeline for later in the year.

In Italy, preliminary contacts have been established for an operation to be decided in 20001. The related request for approval by the Commission services will be sent in due course.

In the Netherlands, a number of opportunities are envisaged under the enlarged investment policy for ETF Start-up (Incubators, seed funds).

In Portugal a team for a potential investment has been identified but substantial further due diligence is required before presenting this operation.

In Spain, one opportunity identified end of last year has been recently abandoned due to difficult fund raising conditions. For the moment, it is difficult to identify potential funds focusing on early stage investments in high technology sectors.

With these potential investments, substantial progress should be made both in the utilisation of ETF start-up funds as well as in the extension of its geographic reach.

2.5. Beneficiary SMEs

As on 31 December 2000, the VC funds have invested in 141 SMEs. The total amount invested is EUR 128.5 million, which corresponds to an average investment of EUR 0.9 million per company.

The breakdown by country is as follows:

Table 2.1. Breakdown by country of beneficiary SMEs

Country	Number of beneficiary SMEs	Amounts invested (EUR million)	Average investment (EUR million)
Finland	10	4.1	0.4
France	76	66.9	0.9
Germany	34	34.0	1.0
Luxembourg	2	2.3	1.2
Sweden	8	12.9	1.6
United Kingdom	7	4.2	0.6
Non-EU (*)	4	4.2	1.1
Total	141	128.5	0.9

(*) US, Israel and Switzerland

Out of the 141 companies, 128 are still in the portfolios of the VC funds and 13 investments are realised. Out of these 13, 12 have been sold and one has been written off.

The table below gives more details about these 13 investments:

Table 2.2. Realised investments

	Investments	Cost (EUR million)	Final value (EUR million)	Gain/Loss (EUR million)	Gain/Loss (%)
Written off	1	0.5	0	-0.5	-100
Sold	12	9.1	16.9	8.8	86
Total	13	9.6	16.9	8.3	76

The breakdown of the 12 companies by number of employees at the time of the investment realisation (exit) is as follows:

Table 2.3. *Employment in beneficiary SMEs of realised investments*

Number of employees	Beneficiary SMEs	
	Number	%
≤ 5	2	17
6-10	0	0
11-50	7	58
>50	3	25
Total	12	100

The classification of the 13 SMEs by sector of activity is as follows:

Table 2.4. *Sector of activity of beneficiary SMEs of realised investments*

Sector of activity	Sold	Written off	Total
Information Technology	6	1	7
Biotechnology/Life Sciences	-	-	-
Communication/Media	3	0	3
Electronics	-	-	-
Medical/Health related	3	0	3
Other high technology activities	-	-	-
Other (non high technology)	-	-	-
Not allocated	-	-	-
Total	12	1	13

The breakdown of the 128 SMEs, which are currently part of the portfolios of the VC funds, by the number of employees at the end of 2000, is as follows:

Table 2.5. *Employment in beneficiary SMEs in portfolios*

Number of employees	Beneficiary SMEs	
	Number	%
≤ 5	22	17
6-10	10	8
11-50	71	55
>50	25	20
Total	128	100

The classification of the 128 SMEs by sector of activity is as follows:

Table 2.6. *Sector of activity of beneficiary SMEs in portfolios*

Sector of activity	Number of beneficiary SMEs
Information Technology	65
Biotechnology/Life Sciences	16
Communication/Media	11
Electronics	2
Medical/Health related	17
Other high technology activities	3
Other (non high technology)	11
Not allocated	3
Total	128

SMEs in the high technology area make up 89% of the total number of SMEs currently in the portfolio of the VC funds, with companies active in information technology accounting for more than 50%.

2.6. Employment

The VC funds reported a total number of 4,796 employees at year-end 2000 in 133 investee companies (excluding non-EU companies, written-off companies and four realised investments). 71 of these companies (the ones that received an investment before the end of 1999 or early 2000) reported an increase in employees from 1,901 (as on 31/12/1999) to 2,686 (as on 31/12/2000). This represents an annual increase of 41%.

Following the results of the annual survey carried out in mid-2000, the expectation of the 69 concerned SMEs in terms of employment creation can be summarised as follows:

Table 2.7. Impact on employment in beneficiary SMEs

	Number of employees	Average per SME	Annual increase in %
Current	1,897	27	-
Expected in one year	3,317	48	75
Expected in two years (*)	4,081	59	23
Expected in five years (*)	5,290	77	30

(*) Around 40% of the surveyed companies were unable to provide these data. For these companies an increase of 0% has been assumed.

More detailed information is included in annex 2.

3. JOINT EUROPEAN VENTURE (JEV)

3.1. Introduction

The development of new commercial outlets in other Member States - either through exporting products or investing directly by producing on-site - offers SMEs a strategic and proactive choice, which allows them to benefit from the considerable advantages of the internal market. However, the fact is that the Europeanisation and internationalisation of trade involves large companies more than SMEs, even in the smaller Member States where, in the absence of a large internal domestic market, SMEs have turned towards other markets to a greater extent than those in the large Member States. This also applies to direct transnational investment (the most highly developed aspect of internationalisation), where the share of SMEs is even lower than for exports.

The European Observatory for SMEs¹ confirms the relative weakness of Europe's 17 million SMEs in terms of internationalisation. It notes that the proportion of exporting undertakings in Italy, the Netherlands, Portugal and Spain rises with the size of the undertaking. In the absence of reliable statistics, the Observatory does not give any figures for the share of SMEs in direct investment, but it points out that direct investment in the form of transnational investment is dominated by the 30,000 large companies, and that there is a close link between exporting and direct investment. A high level of direct investment goes hand in hand with a high level of exports. Each aspect of internationalisation meets a need on the part of undertakings and has shown its worth. Obviously, SMEs must make only those moves necessary to achieve their aims in terms of internationalisation. However, besides their limited human and financial resources, they must face up to the problems involved in accessing a foreign market. Cultures, traditions and regulatory and financial framework are often quite different and SMEs rarely have a good knowledge of foreign languages at the start of the internationalisation phase. Against this background, co-operation with a partner offers considerable advantages for achieving the intended objectives, through careful management of the limited resources and exploiting the reciprocal advantages for the benefit of each partner. It is up to the future partners to select the aspect which best meets their aspirations and means. There can be no doubt that strategic alliances between SMEs, when well prepared, have a high success rate.

The realisation of the internal market created a favourable context for the creation of Joint Ventures. But this *condition sine qua non* does not seem to be sufficient to enable SMEs to set up joint ventures. Effectively, whereas a lot of SMEs wish to set up joint ventures², only a few actually do so. Indeed, obstacles to the internationalisation of SMEs include the absence of adequate financial resources, followed by lack of time and management resources, limited knowledge of foreign languages and ignorance of the legislation governing foreign markets.

The Commission already has several instruments to facilitate the search for information on other markets in the European Union and on potential partners from other Member States. However, implementation of a partnership and, even more so, the setting-up of a joint venture are an expensive and complex affair. The real challenges of internationalisation only start with the identification of the potential partners. The limited financial and human resources, which are traditionally characteristics of SMEs, as well as the general absence of support

¹ 4th report of the European Observatory on SMEs, 1996, EIM Small Business, Research and Consultancy

² 81% following a study realised by KPMG, *Joint Ventures, A Triumph of Hope over Reality?*, KPMG, 1998

from financial institutions because of what they consider a high risk, mean that many transnational co-operation projects are not implemented. This situation is particularly regrettable in the case of good projects, which could have introduced new economic activities and created jobs.

A lot of SME organisations regretted the absence of an instrument helping SMEs to overcome the obstacles, especially since programmes aiming at setting up joint ventures with countries outside the EU existed. The JEV programme was therefore set up. By fostering transnational investments of SMEs and entrusting the marketing of the Scheme and the contacts with companies to financial institutions, JEV fulfils the principle of subsidiarity.

3.2. Description of the programme

The JEV programme aims to encourage joint ventures between European SMEs in the European Economic Area, thereby helping them to benefit from the opportunities offered by the single market.

The contribution is intended to cover some of the expenses related to the setting up of a joint venture. The amount (max. EUR 100,000 per project) and the terms of this contribution are as follows:

- The first part of the contribution covers up to 50 % of the eligible expenses with a maximum ceiling of EUR 50,000.

Eligible expenses are those related to the conception and setting up of a transnational joint venture created by European SMEs. These include the expenses of the market survey, the preparation of the legal framework and the business plan, the analysis of the environmental impact, and any other expenses that are essential for the setting up of the joint venture.

- The second part of the contribution covers up to 10 % of the total amount of the investment made.

In addition, JEV supports actions promoting the Programme from conception through development and distribution of promotional material through any form; and/or- events intended to stimulate co-operation in view of the creation of new transnational joint ventures within the European Union.

The maximum amount of a contribution for Promotion Facility is EUR 10.000 for promotional action material and EUR 20.000 for events intended to stimulate co-operation. It shall consist of 50% of all eligible expenses and shall be in the form of a grant.

Entities which are eligible to apply for a JEV Promotion Facility contribution are financial intermediaries, European, national or regional associations of SMEs, Chambers of Commerce, Euro-Info-Centres, the Business & Innovation Centres, and all other non-profit entities from European Union, such as trade and industry associations, public agencies and other entities, promoting investments eligible for the JEV Programme.

3.3. Development of JEV

The overall administrative environment of the year 2000 was quite difficult for the development of the JEV programme. At the beginning of the year, the Commission decided to close down the Community programmes for joint ventures with SMEs in Central and Eastern Europe and the New Independent States (JOP) and for joint ventures for the countries of Latin

America, Asia, the Mediterranean region and South Africa (ECIP). As the JOP and ECIP programmes had existed since the beginning of the '90s, while the JEV programme was launched in 1998, most of the Financial Intermediaries of the JEV network came from the JOP and ECIP networks. The closure of the two joint venture programmes with third countries induced banks to reduce their staff involved in this business.

The development of the JEV programme in 2000 was somewhat limited. The main reasons for this were the closure of similar programmes, initial uncertainty about the future of JEV, the bureaucratic procedures involved and eligibility criteria that were not always adapted to the market needs of the SMEs.

Indeed, when the draft proposal for a new Multiannual Programme for Enterprise and Entrepreneurship, and in particular for SMEs (2001-2005) was presented by the Commission in April 2000, JEV was not proposed for renewal. However, the other two instruments of the Growth and Employment Initiative, ETF Start-up and the Guarantee Facility, were fully integrated into the Commission Proposal. This gave a certain confusion on the future of JEV beyond the end of the year 2000, and hence a considerable number of financial intermediaries no longer promoted JEV. Only in late autumn, at the request of the European Parliament, did the Commission add the JEV programme to its proposal. The Council then approved the inclusion of JEV in its decision of 20 December 2000 on the Multiannual Programme for Enterprise and Entrepreneurship, and in particular for SMEs, (2001-2005).

Moreover, the business environment for JEV was not favourable and SMEs had to wait longer than expected for payment and approval, as the Commission had to apply very strict, time consuming and burdensome control mechanisms in order to protect the interests of the European budget.

This explains why the number of new proposals submitted by SMEs was below forecasts.

However, the prospects for the future are positive, for various reasons. Based on the mandate given by the Council, the new JEV programme will be simplified. This will enable SMEs' requests for financial contributions to be dealt with more rapidly, both by the financial intermediaries and by the Commission services, and to ensure that Community resources are used correctly. Furthermore, the eligibility criteria of JEV will be adapted and the programme opened to candidate countries.

3.4. Budgetary situation

3.4.1. Overview

The initial amount of the budgetary allocations foreseen for the JEV programme totalled EUR 89 million, including EUR 5 million allocated in 1997 for the JEV pilot action. Out of this total amount, EUR 57 million was committed and made available for projects. The remaining part was transferred to the SME Guarantee Facility.

3.4.2. Geographic distribution

For JEV, as the projects are by definition transnational, geographic distribution of budgetary allocations by Member States is not relevant. Hence, the geographic distribution is analysed in the context of the review of the projects under point 3.5. hereunder.

3.4.3. Commitments

At the end of 2000, Commission services had committed EUR 8.8 million of the available budgetary resources to final beneficiary SMEs.

3.4.4. Disbursements

As on 31 December 2000, the total disbursements to beneficiary SMEs amounted to EUR 1.1 million. This apparently low level of disbursements is due to the time needed for the preparatory phases of the joint ventures and for the eventual realisation of the investments.

3.4.5. Accounts

The financial statements of the programme are enclosed in annex 7.

3.5. Financial Intermediaries

The JEV programme is implemented through a network of financial institutions. This network, composed following a call for expressions of interest (official Journal S 42 of 28 February 1998) comprises 85 financial intermediaries. A complete list of these financial intermediaries is attached (annex 3).

The table below gives an overview of the financial intermediaries by country:

Table 3.1. *Breakdown of financial intermediaries by country*

Country	Number of financial intermediaries
Austria	7
Belgium	6
Denmark	2
Finland	1
France	10
Germany	10
Greece	2
Ireland	1
Italy	23
Luxembourg	3
Netherlands	1
Norway	1
Portugal	2
Spain	13
Sweden	1
UK	2
Total	85

An SME that wishes to submit an application under this scheme must contact one of the financial intermediaries in the network. This intermediary is entrusted with evaluating the application and passing it on to the Commission services. The latter will then verify the eligibility of the application and the possible impact on employment.

Out of these 85 financial intermediaries, only some are active, while the others are rather “sleeping” partners. The 10 most active financial intermediaries account for 90% of the projects.

3.6. Review of the projects

From the start in 1998 until 31 December 2000, after an in-depth assessment of potential projects by the financial intermediaries, finally 186 projects have been received and 129 have been approved by the Commission services. Among them, 46 were promotion projects and 83 were preparatory work and investment projects. The table below summarises the evolution of projects:

Table 3.2. Projects status

(Cumulative figures)	Projects		
	31.12.1998	31.12.1999	31.12.2000
Projects received			
Joint Venture Projects	23	79	127
Promotion Facility	-	25	59
Total	23	104	186
Projects approved			
Joint Venture Projects	11	53	83
Promotion Facility	-	12	46
Total	11	65	129
Projects rejected	2	5	17
Projects withdrawn	2	9	23
Projects under review	8	25	18

The first year of the JEV programme (1998) was used by the Commission services to build the network of financial intermediaries and to implement the scheme. In the second year of the programme 81 projects were received, which is four times more than in 1998. In 2000 the number of projects received remained at the same level as the year before. This was lower than expected.

During the three years, almost one out of four projects was refused or was withdrawn by the financial intermediaries. Most of the withdrawals are due to the administrative requirements for the processing of the files. Concerning refusals, most were due to an insufficient effect on employment, non-compliance with the SME criteria or an unbalanced partnership.

A brief description of some of the projects approved is attached (annex 4)

The table below shows the location of the planned joint ventures:

Table 3.3. *Breakdown by country of the planned joint ventures*

	Planned joint ventures		
	1998-1999	2000	Total
Austria	0	1	1
Belgium	7	1	8
Denmark	3	3	6
Finland	1	0	1
France	10	1	11
Germany	3	4	7
Greece	0	1	1
Ireland	1	0	1
Italy	7	3	10
Luxembourg	1	0	1
Netherlands	3	1	4
Norway	0	0	0
Portugal	5	3	8
Spain	9	7	16
Sweden	1	2	3
United Kingdom	2	2	4
To be defined	0	1	1
Total	53	30	83

It can be seen that almost all EU countries are involved with some having proportionally a very large share of the projects. This coincides with the countries where the financial intermediaries are more active.

Nationalities of partners involved in projects are as follows:

Table 3.4. *Breakdown by country of joint ventures' partners*

	Partners		
	1998-1999	2000	Total
Austria	1	3	4
Belgium	14	5	19
Denmark	7	5	12
Finland	1	0	1
France	22	5	27
Germany	11	6	17
Greece	0	1	1
Ireland	1	2	3
Italy	11	7	18
Luxembourg	1	0	1
Netherlands	6	7	13
Norway	0	0	0
Portugal	8	3	11
Spain	13	11	24
Sweden	3	3	6
United Kingdom	16	5	21
Other	0	3	3
Total	115	66	181

The number of planned joint ventures by sector of activity is as follows:

Table 3.5. *Sector of activity of planned joint ventures*

	Planned joint ventures		
	1998-1999	2000	Total
Multimedia, software, audio-visual	2	0	2
Marketing and commercialisation	7	6	13
Manufacturing	3	11	14
Waste management	2	0	2
Biotechnology	1	1	2
Transports, logistics	7	1	8
Information technology	15	5	20
Energy	2	2	4
Construction	4	0	4
Industry	5	0	5
Telecommunications and data-processing	2	0	2
Other services	3	4	7
Total	53	30	83

It is also worth noting that out of the 181 SMEs selected, 54 % concerned SMEs that had fewer than 10 employees, another 31 % concerned SME with between 10 and 49 employees. This shows that JEV meets the needs of small enterprises.

The size of the SMEs, involved in the approved joint venture projects (until 31 December 2000) is as follows:

Table 3.6. Employment in partner SMEs

Number of employees	Number of SMEs (cumulative figures)	
	31.12.1999	31.12.2000
< 10	48	97
10-49	46	56
50-249	21	28
Total	115	181

3.7. Employment

By the end of 2000, about 10 new joint ventures had been created; this is in line with expectations. In fact, the average duration between the preparatory phase and the effective creation of the joint venture is between 18 months and two years. Since the JEV programme took off at the end of 1998, it is only now that the first joint ventures are being set up.

Although it is too early to measure the effect on employment, first indications seem positive. Based on the information received from applicants, the foreseen impact on job creation is approximately 14 jobs per project on average.

4. SME GUARANTEE FACILITY

4.1. Introduction

According to the sixth annual report of the European Observatory for SMEs³, SMEs encounter specific problems in their attempts to access finance. Bank credit is common and is the only external source of financing for many enterprises. The main reason for the difficulty to access appears to be the lack of collateral.

While the situation has improved in recent years, access to finance remains difficult for certain companies, such as micro-enterprises, start-ups and innovative, fast growing SMEs. These enterprises present strong job-creation potential. According to the latest figures available⁴, very small enterprises with 1 to 9 employees recorded the biggest increase in terms of job-creation in the European Union. Small enterprises have a higher rate of employment expansion and they also employ more women and young workers.

Satisfactory development of the SME Guarantee Facility reflects the market gap and explains the subsequent acceptance by market players of this type of Community involvement. Under the SME Guarantee Facility, small enterprises with 1 to 9 employees represent over 90% of the SMEs that benefited from the Facility.

The following chapters on the SME Guarantee Facility have been drafted using two types of information:

- Aggregate figures like global commitments and guarantee volumes. This information relates to 31 December 2000;
- Detailed information concerning the operations of the financial intermediaries in favour of SMEs. This available information as reported by the financial intermediaries relates to 30 September 2000.

This report is complemented by a specific SME annex (annex 6) illustrating aggregate data on the beneficiary SMEs from late 1998 until the end of 1999. The data is based on information contained in a specific report to be submitted by the EIF to the Commission services annually in September. It is important to stress that the information received in September 2000 refers to the year 1999.

4.2. Description of the Facility

The objective of the SME Guarantee Facility is to stimulate job-creation by supporting the investment activities of SMEs within the European Union, through increased availability of loan finance. This is achieved by increasing the capacity of guarantee schemes operating in the Member States and relates to both new and existing portfolios. This Facility provides higher volumes of guarantees for the existing guarantee products of the financial intermediaries, access to financing for a larger number of small companies for a wider variety of investments and guarantees for riskier loans. The Facility covers part of the losses incurred under the guarantees up to a pre-determined amount. The Facility is operated by the European Investment Fund (EIF) on a trust basis. It manages the contacts with financial institutions

³ The European Observatory for SMEs - Sixth Annual Report, Luxembourg

⁴ Eurostat, Statistics in focus, Industry, Trade and services, Theme 4, 11/2000.

interested in joining the Facility, evaluates and submits the selected proposals to the Commission services for eligibility approval. Appropriate co-operation with Member States is ensured by contacts between the EIF and the relevant national authorities.

The SME Guarantee Facility gives priority to companies with up to 100 employees. Particular attention is given to financing of the intangible assets of SMEs. The financial intermediaries may have stricter SME eligibility criteria depending on their specific guarantee or loan products. In any case, the approval process, with regard to the final SME beneficiaries, is the full responsibility of the selected financial intermediaries.

4.3. Budgetary situation

4.3.1. Overview

The initial amount of the budgetary allocations foreseen for the SME Guarantee Facility totalled EUR 168 million for three years, including EUR 59 million allocated in 2000. Due to the rapid development of the Facility, further budgetary funds amounting to EUR 30.56 million were transferred from the JEV programme to the Facility in December 2000, increasing its total resources to EUR 198.56 million.

4.3.2. Geographic distribution

At the end of 2000, the EIF had committed EUR 130 million of the available budgetary resources. The geographic distribution of these commitments is shown below:

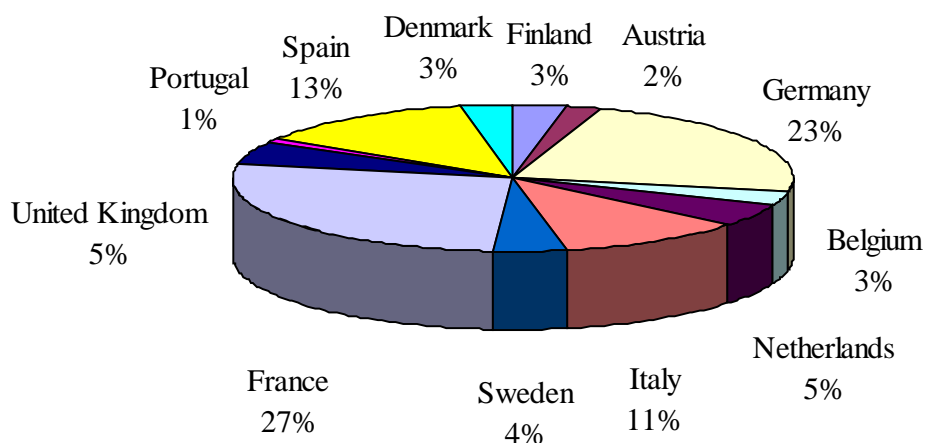


Figure 4.1. Breakdown by country of the financial intermediaries

4.3.3. Commitments

Quarterly EIF commitments to financial intermediaries are shown in the graph below:

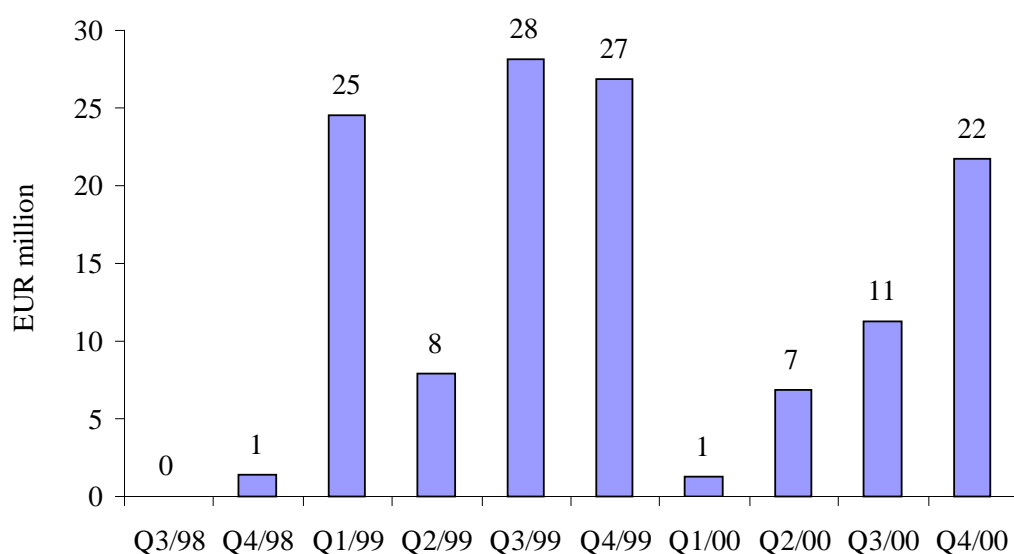


Figure 4.2. Quarterly EIF commitments to financial intermediaries

The graph below shows the evolution of the EIF commitments (EUR 130 million end 2000) compared to the available committed budgetary resources (EUR 198.56 million end 2000). In addition, it indicates the actual utilisation of the budgetary resources by the financial intermediaries.

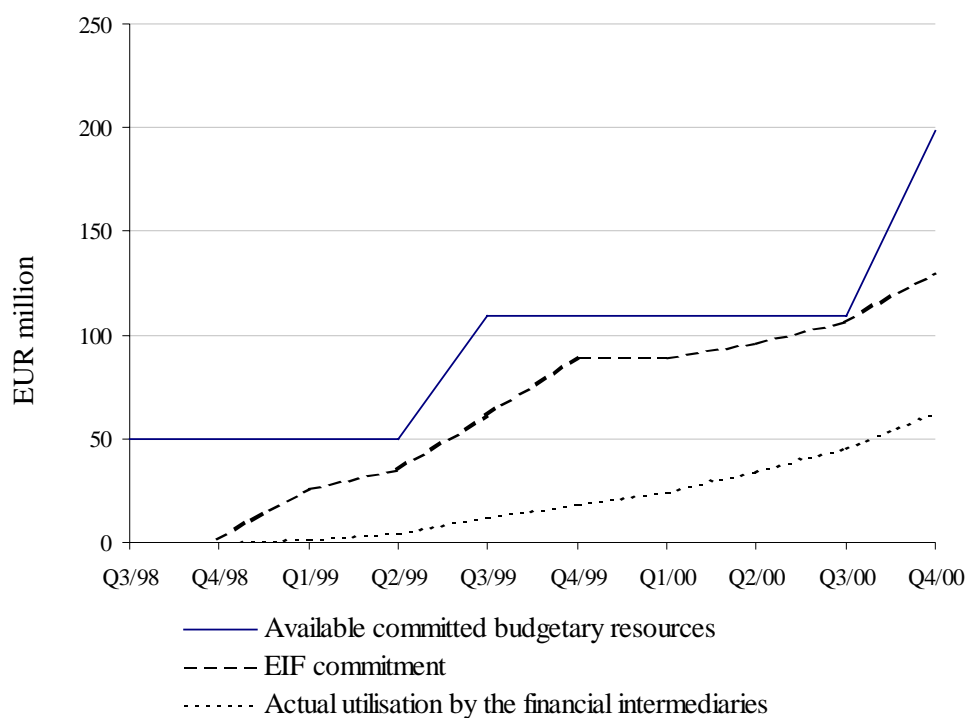


Figure 4.3. Cumulative evolution of operations

Guarantee schemes in general have a high leverage effect. As on 31 December 2000, the aggregate amount of loans granted to SMEs under the Facility totalled EUR 3.4 billion. At the same time, the actual utilisation of the budgetary resources by the financial intermediaries amounted to EUR 62 million, achieving a leverage effect of 54. According to the forecasts by the financial intermediaries, it is estimated that more than EUR 6.6 billion of loans will be granted on the basis of the commitments of EUR 130 million.

The following graph shows the development of the loans to SMEs and the corresponding amounts that the beneficiary SMEs have invested so far:

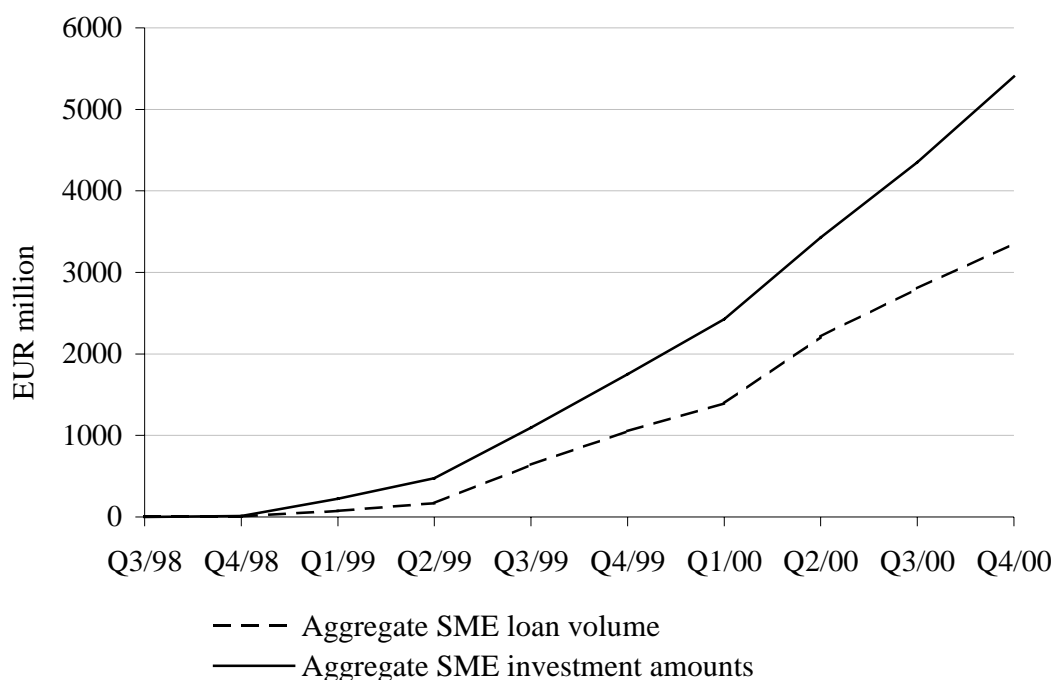


Figure 4.4. *Loans granted to SMEs and corresponding investments*

It is worth mentioning that the first financial intermediaries that have signed a contract with the EIF (either in the last quarter of 1998 or in the first quarter of 1999) have already used on average 77% of their total guarantee portfolio by 31 December 2000. This is in line with the original forecasts and states a satisfactory development of the Facility. In fact, at the end of 1999 and in 2000 the EIF has already negotiated with some of the financial intermediaries to increase the relevant portfolio volumes.

4.3.4. *Loss payments*

The first guarantee calls were made by the financial intermediaries in the third quarter 2000. The amount of the EIF's portion in regard to the defaulted loans totals EUR 446,028 so far. This result is in line with the nature of the guarantee or loan products covered by the Facility. It also reflects the time lag between the signing of the guarantee agreements between the EIF and the financial intermediaries and the occurrence of defaults in the underlying portfolios. All four financial intermediaries concerned (Bürges in Austria, Finnvera in Finland, Deutsche Ausgleichsbank in Germany and Almi in Sweden) signed an agreement with the EIF either at the end 1998 or in 1999.

4.3.5. Accounts

The balance sheet and the profit & loss accounts of the facility are enclosed in annex 7.

4.4. Financial Intermediaries

The EIF has succeeded in signing contracts with 21 financial intermediaries in 12 countries. As anticipated, in some countries, where guarantee schemes do not exist and/or where the public interest in the Facility was low, the implementation by the EIF turned out to be rather difficult. This is in particular the case for Greece, Ireland and Luxembourg.

A list of the financial intermediaries and a short description of the financing products guaranteed under the SME Guarantee Facility is annexed (annex 5).

The following graph shows the utilisation of the EIF commitments by country as on 30 September 2000. The utilisation is calculated as the ratio between aggregate amount of the guarantees included in the relevant SME Guarantee Facility portfolio of each intermediary divided by the maximum guarantee portfolio volume contractually agreed for the intermediary.

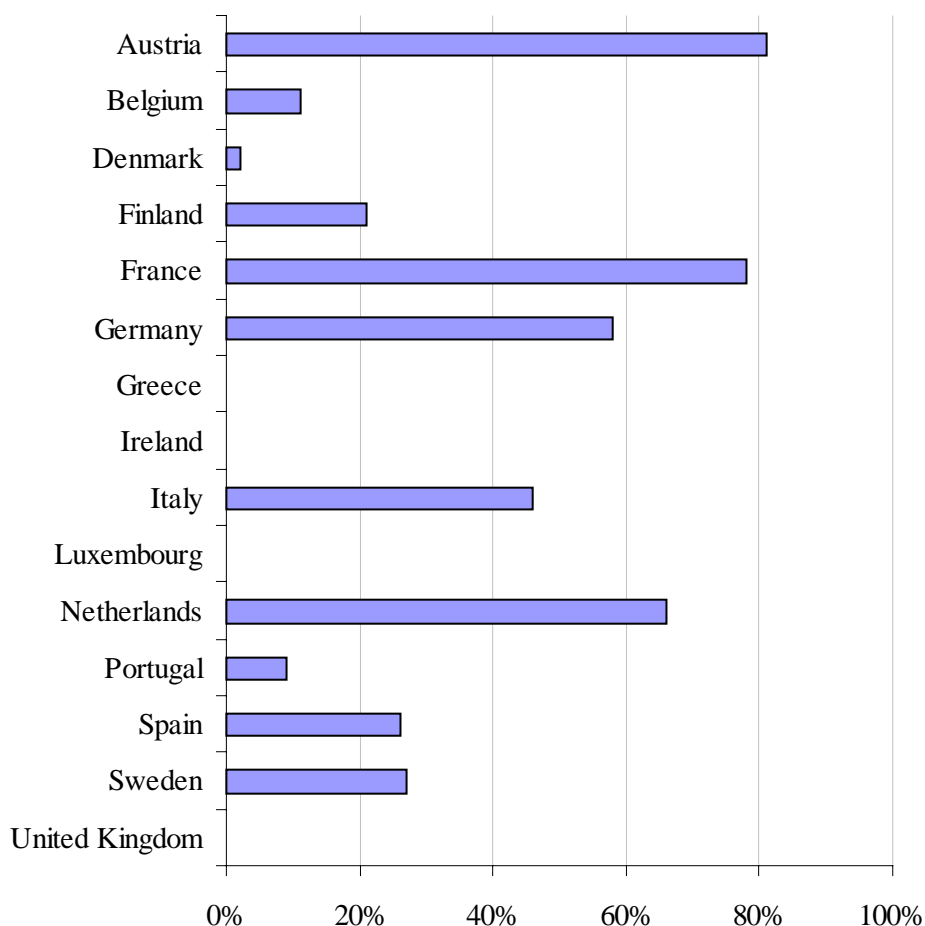


Figure 4.5. *Utilisation by financial intermediaries*

Some comments on the development of the Facility in each country are given below:

Austria

Bürges has developed its operations under the Facility very well and it will request an extension of the contract and an increase of the relevant portfolio volumes in 2001. The preliminary year-end information shows an utilisation rate of 96%.

Belgium

The utilisation was delayed. At first, Fonds de Participation – Participatie Fonds introduced, in the beginning of 1999, a new loan guarantee product in support of SMEs with up to 50 employees and with a business activity of less than 5 years. However, as the utilisation of this new instrument by the commercial banks turned out to be unsatisfactory, EIF entered into a new contract in the summer 2000 to cover subordinated loans to start-ups. This immediately led to an increase in utilisation.

Denmark

The utilisation of the Facility has been highly satisfactory. The Growth Fund (Vækstfonden) signed a contract with the EIF in June 2000. With the support of the Facility it launched a new loan guarantee scheme that began its operations in August 2000. According to the preliminary information, as on 31 December 2000 the utilisation rate of the new scheme is 25% in terms of loan disbursements. However, in terms of loan granted already 90% have been committed. Therefore, an increase of the relevant portfolio volumes will be requested later on in 2001.

Finland

Finnvera requested to include its small enterprise guarantee scheme into the SME Guarantee Facility portfolio at the end of the year. A special window was designed for companies that are owned by young people. According to the preliminary information, as of 31 December 2000 the utilisation rate is 28%.

France

The selected portfolio consists of three programmes: start-up, business transfer and investment by micro-enterprises (up to 10 employees). The EIF has increased the relevant portfolio volumes of Sofaris to enable the institution to continue its operations. More than 13,000 loans have been granted so far.

Germany

Due to an extremely positive utilisation of the loan product of Deutsche Ausgleichsbank, the amounts of the relevant portfolio volumes were increased in August 2000. In addition, the EIF signed a contract with Kreditanstalt für Wiederaufbau in December 2000.

Greece

The relevant law that will allow such a guarantee scheme to be established has not yet been approved.

Ireland

The consultations concerning possible financial intermediaries are still taking place at the level of the national authorities.

Italy

The EIF has signed contracts with 9 guarantee schemes that operate at a regional level. The utilisation of the Facility is satisfactory and the leverage effect of the budgetary resources is very high. Relevant guarantee volumes of two intermediaries have already been increased to enable the institutions to continue their good performance. Further increases will be considered in 2001.

Luxembourg

Only one potential institution has shown interest so far. If a suitable product can be defined under the Facility, the intermediary may join the network later in 2001.

The Netherlands

The development of the Facility by BBMKB (Besluit Borgstelling MKB kredieten) has been more than satisfactory. Therefore, an increase of the relevant portfolio volumes will be requested in 2001.

Portugal

The EIF signed a contract with the Portuguese SPMG (Sociedade de Investimento) in June 2000. SPMG manages a newly established national guarantee scheme. The Facility supports the intermediary in its effort to establish a mutual guarantee system in the country. The take-up rate is quite low at the moment as the implementation process of the new system is still on going.

Spain

The utilisation rate of 26% by CERSA (Compañía Española de Reafianzamiento) is in line with the expectations. The scheme provides coverage to national mutual guarantee schemes nation-wide. Thanks to the support of the Facility, CERSA changed its product from a guarantee with capped liability into a guarantee with unlimited liability.

Sweden

The Facility enabled Almi Företagspartner to increase its activities in the framework of growth financing, start-up loans and loans to female entrepreneurs. According to the preliminary information, as on 31 December 2000, the utilisation rate was 38%.

The United Kingdom

The Prince's Trust signed a contract with the EIF only in December 2000 and therefore has not yet carried out any operations that could be included in this report.

4.5. Beneficiary SMEs

As on 30 September 2000, the total number of SMEs benefiting from the SME Guarantee Facility is 40,778 compared with 7,223 last year. The following table shows the breakdown by country and the corresponding aggregate loan amounts:

Table 4.1. Breakdown by country of beneficiary SMEs

Country	Number of beneficiary SMEs	Loan amounts (EUR million)	Average loan amount (EUR 000)
Austria	2,218	218	98
Belgium	166	5	30
Denmark	11	2	181
Finland	356	81	228
France	13,463	1,070	79
Germany	8,950	300	34
Italy	9,836	604	61
Netherlands	1,645	272	165
Portugal *)	8	10	1,250
Spain	2,182	264	121
Sweden	1,943	62	32
Total	40,778	2,887	71

*) SPMG is in the process of establishing a mutual guarantee system in Portugal. As the mutual guarantee funds are not yet operational, SPMG has issued guarantees under its normal activities to SMEs.

In accordance with the preliminary information submitted by the financial intermediaries, more than 50,000 SMEs will have benefited from the Facility at the end of 2000.

Final beneficiaries with up to 10 employees made up 91% of the total number of SMEs. It is interesting to compare the distribution of SMEs by size under the Facility with that of the EU in general. According to the European Observatory for SMEs, sixth report, 93% of SMEs are micro enterprises, 6% are small enterprises and 1% are medium sized enterprises. Consequently, the population of the beneficiary SMEs of the SME Guarantee Facility is similar to the global EU SME distribution.

The classification in terms of the number of employees is as follows:

Table 4.2. Employment in beneficiary SMEs

Number of employees	Beneficiary SMEs	
	Number	%
0-5	33,657	83
6-10	4,286	10
11-20	1,593	4
21-50	948	2
51-100	286	1
Not available	8	0
Total	40,778	100

The classification of the SMEs, in terms of their year of establishment, is as follows:

Table 4.3. Breakdown of beneficiary SMEs by year of establishment

Year of establishment	Number of beneficiary SMEs
<1998	16,463
1998	1,749
1999	6,048
2000	8,455
2001*)	2
Not available**)	8,025
Total	40,778

*) The loans were granted as a pre-start financing before the companies were established.

**) This data mainly concerns Sofaris. It is estimated that, approximately 30% of Sofaris's guarantee portfolio relate to its start-up programme. Therefore, out of the 10,178 SMEs for which data on the year of establishment is not available, some 3,000 are start-ups. Of these, it is estimated that approximately 1,200 companies were created in 2000.

4.6. Employment

The 40,778 SMEs benefiting from the SME Guarantee Facility have so far declared that they have 175,174 employees. They have also indicated that they expect an increase of 19,084 employees within one year and a further increase of 33,934 within a second year. Hence it is estimated that the SMEs that have benefited from the Facility will create a total of around 52,018 new jobs within two years or an average of 1.3 new jobs per SME. This is substantial, if one remembers that more than 80% of the beneficiary SMEs are very small companies with up to 5 employees.

5. CONCLUSIONS

5.1. Growth and Employment Initiative

SMEs are not homogeneous, which is why under the Growth and Employment Initiative different kinds of support measures have been developed for different categories of enterprises. The three financial instruments - ETF Start-up Facility, JEV and SME Guarantee Facility - contribute in varying degrees to the development of SMEs. They support the creation and the growth of businesses as well as co-operation between businesses.

The degree of development of these three instruments varies considerably. The ETF Start-up Facility is still at an early stage of its investment phase. Considering the complexities involved (establishment of new VC funds often with new management teams), the results achieved so far may be considered to be satisfactory. The EIF expects that the total remaining budgetary allocation will be committed by the beginning of 2002, taking into account commitments to further VC funds already under negotiation or in advanced stages of appraisal as well as the steady flow of new proposals from potential fund managers and sponsors.

As regards to JEV, the take-up of the programme is slower than expected due to multiple reasons. It is considered that the processing time of the SME submissions is too long. In addition, the current eligibility criteria do not respond to SMEs' needs with regard to cross-border investments. For some SMEs the co-operation with a foreign partner, including the sharing of management responsibilities may be considered to be a burden. Therefore, the new MAP foresees a simplification of the procedures and an extension of the relevant eligibility criteria.

Finally, the global take-up of the SME Guarantee Facility has been satisfactory and reflects an acceptance by market players as well as the necessity for this type of Community involvement.

Taking account of the absorption of the three instruments, the Commission has adapted the allocation between the schemes by reallocating EUR 30.56 million from JEV to SME Guarantee Facility.

On 20 December 2000 the Council decided to extend the three financial instruments of the Growth and Employment Initiative under a new legal basis, the multiannual programme for enterprises and entrepreneurship (MAP), and in particular for small and medium-sized enterprises (2001-2005). Furthermore, the Seed Capital action (the former CREA) continues to be an integral part of the MAP and will be managed by the EIF.

5.2. Multi Annual Programme

The credits proposed for financial instruments under the new MAP (EUR 317 million for the period 2001-2005) are allocated to the SME Guarantee Facility, the ETF Start-up Facility and the Seed Capital action.

In order to provide the accession candidates with the opportunity to become familiar with community policies and instruments, the MAP has been opened up to the potential accession countries. Furthermore, the agreement on the European Economic Area (EEA) concluded with the ETFA/EEA countries as well as the Association Agreements concluded with Cyprus,

Malta and Turkey, provide for a possibility of a participation of those countries in Community programmes.

Within the new MAP, the ETF Start-up Facility has been adapted to support the establishment and financing of SMEs in their start-up phase, by investing in specialised VC funds and incubators.

Concerning the SME Guarantee Facility three new sub-windows have been added in order to enlarge the range of available instruments to guarantee:

- micro credits; furthermore additional aid to financial intermediaries can be envisaged in order to partially offset the high administrative costs inherent in such activities,
- equity investments and
- loans to cover IT equipment, software and training in the area of internet and e-commerce.

The Seed Capital Action plan is intended to support seed funds, incubators or similar organisations in which the EIF participates.

Finally, the JEV programme will be simplified and eligibility criteria adapted. It will focus on transnational partnerships. The method of calculating the amount of the contribution will be simplified through the use of a lump sum to cover part of the preparatory works. Furthermore, the contribution will be linked both to the investment realised and the number of jobs created.

This simplification will have the effect of reducing the administrative burden and enabling financial intermediaries and the Commission services to deal quickly with the projects. It will also allow the Commission services to manage the scheme without the aid of a technical assistance unit.
